

**BEFORE THE COMMISSIONER OF FINANCIAL INSTITUTIONS
STATE OF TENNESSEE**

IN THE MATTER OF:)
)
SENTINEL TRUST COMPANY,)
Hohenwald, Tennessee,)
)
AND)
)
Danny N. Bates, Clifton T. Bates,)
Howard W. Cochran, Bradley S. Lancaster,)
Gary L. O'Brien,)
)
Members of the Board of Directors of)
Sentinel Trust Company,)
Hohenwald, Tennessee,)
)
Respondent.)

**NOTICE OF CHARGES AND OPPORTUNITY
FOR SUBSEQUENT HEARING**

Notice is hereby given that Kevin P. Lavender, Commissioner of the Tennessee Department of Financial Institutions ("Commissioner"), has issued an **EMERGENCY ORDER** directing Respondent, Sentinel Trust Company, to **CEASE** and **DESIST** from engaging in unsafe and unsound banking practices hereinafter set forth. Notice is also given that the Respondent has a right to a subsequent hearing to contest the issuance of this **EMERGENCY ORDER**. Such a hearing, if timely requested by Respondent, shall be conducted in accordance with Chapter 0180-6 of the Rules of the Department of Financial Institutions and the Uniform Administrative Procedures Act, T.C.A. §§ 4-5-301, *et seq.*

I. AUTHORITY

The Commissioner is vested with the power to issue an **EMERGENCY CEASE AND DESIST ORDER** in this proceeding pursuant to T.C.A. §§ 45-1-107 (a)(4), (a)(5) and (c). Sentinel Trust Company, Hohenwald, Tennessee, is a state-chartered trust company subject to the Commissioner's jurisdiction and the trust company's directors, who are responsible for management and policies, are persons subject to his jurisdiction.

II. FACTUAL ALLEGATIONS

1. Sentinel Trust Company was originally formed under the Tennessee Business Corporation Act.
2. Pursuant to Public Chapter 112 of the Acts of 1999, as codified at T.C.A. § 45-1-124, a company engaged in activities subject to the Tennessee Banking Act on July 1, 1999, but formed prior to the enactment of Public Chapter 620 of the Acts of 1980 and not previously subject to regulation by the Commissioner, may continue to act as a fiduciary without submitting an application. However, such entity shall be otherwise fully subject to the Banking Act.
3. Sentinel was engaging in fiduciary activities on July 1, 1999 and has been subject to regulation by the Commissioner since that time.
4. On June 16, 2003, the Department began an examination of Sentinel Trust Company. During the examination, Sentinel's audit firm, Charles Welch and Associates, Nashville, withdrew and declined to complete the December 31, 2002 audit of the company due to the inability to obtain evidence needed to evaluate the fair value of certain receivables. The Department's trust examiner has been unable to determine the

accuracy and validity of fiduciary cash reconcilements and other corporate and fiduciary financial statements and records in order to determine the solvency of the company. (See affidavit of Vivian Lamb attached to the Notice of Charges as Exhibit "A").

5. The Commissioner met with the Board of Sentinel Trust on October 6, 2003 to discuss the urgency of obtaining a financial statement audit.

6. Thereafter, on October 10, 2003, Sentinel President Danny Bates advised the Department's trust examiner that Kraft CPAs, ("Kraft") located in Columbia, Tennessee had been engaged to perform an audit of the company as required by T.C.A. § 45-2-402(c) and Department Bulletin B-02-2 as of December 31, 2002.

7. Subsequently, Kraft advised the Department's trust examiner that the audit was impeded due to the inadequacy and questionable accuracy of Sentinel's fiduciary and corporate cash records and reconcilements.

8. Kraft informed the Department that Sentinel had retained an independent contractor to reconcile the corporate and fiduciary accounts.

9. On January 7, 2004, Kraft issued an audit report as of December 31, 2002. The Department obtained a copy of the audit on March 19, 2004.

10. As of the December 31, 2002 audit, Kraft identified fiduciary accounts receivable of approximately \$9.4 million, of which approximately \$7.5 million resulted from expenditures made in connection with defaulted bond issues and related unreimbursed costs and expenses. The Auditors stated that the company's records were not adequate for them to satisfy themselves as to the existence, amount or collectability of these receivables. Kraft noted that Sentinel has a fiduciary duty, as trustee, to safeguard assets under administration and could be held responsible for any shortfalls.

Kraft could not determine the liability, if any, which could result from the ultimate resolution of this matter.

11. Because of the materiality of the matter discussed in item 10 above, Kraft declined to give an opinion because Kraft stated that the scope of their work was not sufficient to enable them to express, and they did not express, an opinion on the financial statement of Sentinel Trust Company. Kraft has commenced an audit as of December 31, 2003, but to our knowledge, this audit has not been completed.

12. As the Department understands and as Kraft's audit noted, in the normal course of business Sentinel makes various commitments and incurs certain contingent liabilities that are not represented on its balance sheet. As of the December 31, 2002 audit, Kraft noted that Sentinel was a defendant in a lawsuit alleging breach of its fiduciary duties in connection with the issuance of certain corporate notes. Kraft further noted that counsel for Sentinel has asserted that an award of damages is unlikely, but could reach \$2,500,000.

13. On April 5, 2004, the Department sent a letter to Sentinel requesting an opinion of counsel regarding Sentinel's practice of funding defaulted bond expenses with funds from other non-related bond issues (See Exhibit A attached to the Notice of Charges). This letter stated that it was the Department's understanding that Sentinel serves as the indenture trustee for various high-yield, unregistered municipal and corporate bonds. In some instances, the debtor fails to make the scheduled principal and interest payments and default is declared per the terms of the indenture. Oftentimes the debtor will seek bankruptcy protection, which triggers an automatic stay and prevents any

action from creditors until a plan of reorganization, debt restructuring and/or sale of collateral is approved by the bankruptcy court.

Further, the Department stated that it was its understanding that Sentinel, in its role as indenture trustee, in many instances funds various expenses relative to these defaulted issues, such as insurance, security, legal and other professional fees, in an effort to protect the value of the underlying collateral. The governing indenture and/or bondholder indemnification usually provides for the reimbursement of these expenses from the proceeds of the sale of the collateral. However, since Sentinel does not have adequate corporate liquidity to fund these expenses, it appears that Sentinel usually "borrows" from other non-related bond issues to fund these expenses. This is done by writing checks and/or wires on a pooled demand deposit account held at SunTrust Bank, Orlando, Florida. President Bates has stated that this is a "common industry" practice. Finally, the letter requested that Sentinel provide a written legal opinion addressing the legal basis of such practice.

14. In response to the April 5, 2004 letter, Sentinel's counsel requested a meeting with the Commissioner. On April 28, 2004 Sentinel's Executive Vice President Paul Williams and Sentinel's attorneys Alex Buchanan and David Lemke met with the Commissioner. At this meeting, Counsel for Sentinel indicated that the practice of funding defaulted bond expenses with funds from other non-related bond issues was inappropriate. They indicated that the expenses attributable to defaulted bonds are typically funded with corporate assets.

15. At the April 28, 2004 meeting, counsel, on behalf of Sentinel, requested permission for Sentinel to continue on a temporary basis the practice of "borrowing"

funds from one bond issue to cover the expenses of unrelated defaulted bond issues. The Commissioner declined to approve that request.

16. Counsel for Sentinel also stated at the April 28, 2004 meeting that Sentinel's fiduciary cash shortfall is believed to be between \$8-10 million.

17. On April 30, 2004 the five members of Sentinel's Board and their counsel met with the Commissioner. At that meeting President Danny Bates stated that Sentinel's most recent calculations show that Sentinel had a deficit fiduciary cash position of seven million two hundred fifty thousand dollars (\$7,250,000). However, Mr. Bates indicated that this figure fluctuates daily. Finally, Mr. Bates stated that Sentinel's corporate cash account had a current balance of fifty three thousand dollars (\$53,000). The Department believes that the amount of cash is inadequate to pay the operating capital needed for the administration of the defaulted bonds for the immediate future.

III. CHARGES

Having considered these factual allegations and the entire matter as a whole, and based in part upon the preliminary findings of the Department's ongoing examination which commenced on June 16, 2003, the audit findings of Kraft CPAs, and the statements by company personnel and their counsel, the Commissioner has determined that Respondent, Sentinel Trust Company, has engaged in unsafe and unsound banking practices including, but not limited to:

1. Operating in an unsafe and unsound manner by using the pooled fiduciary funds to provide operating capital for non-related defaulted bond issues. This practice has created a fiduciary cash shortfall which changes on a daily basis. President Bates

informed the Commissioner on April 30, 2004 that the shortfall is \$7,250,000 (seven million two hundred fifty thousand dollars.) This shortfall greatly exceeds Sentinel's current operating capital;

2. Operating with an inadequate level of capital for the kind and quality of accounts held under administration;

3. Operating in an unsafe and unsound manner by failing to reconcile fiduciary cash and corporate cash accounts in a timely and accurate fashion; and

4. Operating in an unsafe and unsound manner by failing to keep accurate books and records.


IV. RESPONDENT'S RIGHTS

Respondent has the right to a subsequent hearing, the right to be represented by counsel, the right to present evidence in its own behalf, the right to cross examine any witnesses called by the Commissioner of Financial Institutions and all other rights pertaining to contested cases under T.C.A. §§ 4-5-301, *et seq.*, and Chapter 0180-6 of the Rules of the Department of Financial Institutions.

V. FILING OF ANSWER AND REQUEST FOR HEARING

Respondent is hereby advised that the **EMERGENCY ORDER TO CEASE AND DESIST** is effective immediately upon receipt. In order to request a subsequent hearing, the Respondent must file an answer within thirty (30) days from receipt of this **NOTICE**. If no such answer is filed within the specified time period, the **EMERGENCY ORDER** will be deemed a **FINAL ORDER**. The answer herein

required shall be filed with the Commissioner of Financial Institutions, Suite 400,
Nashville City Center, 511 Union Street, Nashville, Tennessee, 37219.



KEVIN P. LAVENDER, COMMISSIONER
Tennessee Department of Financial Institutions

CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing **NOTICE OF CHARGES AND OPPORTUNITY FOR SUBSEQUENT HEARING** and **EMERGENCY ORDER TO CEASE AND DESIST** was hand delivered to David Lemke, Attorney for Sentinel Trust Company Board of Directors, Waller Lansden, Dortch & Davis, 511 Union Street, Suite 2100, Nashville, Tennessee, 37219 and sent via Overnight Mail to the members of the Board of Directors of Sentinel Trust Company, Hohenwald, Tennessee this 3rd day of May, 2004.

Teri L. Hult